

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
CURTIS H. LEE)

For Appellant: Christine V. Pate
Attorney At Law

For Respondent: Bruce W. Walker
Chief Counsel

Jacqueline W. Martins
Counsel

O P I N I O N

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Curtis H. Lee against a proposed assessment of additional personal income tax in the amount of \$131.85 for the year 1975.

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The sole issue is whether appellant properly deducted certain legal fees incident to a divorce in computing his taxable income for 1975.

Appellant, an engineer with a professional engineering firm, obtained a divorce in 1975. Legal fees in the amount of \$1,786.50 were incurred incident to the divorce. Appellant deducted \$1,200.00 of that amount on his 1975 personal income tax return. Respondent disallowed the entire \$1,200.00 deduction and issued the proposed assessment in question.

In support of his position appellant had submitted a copy of the bill from his attorney which states:

| | |
|---|--------------|
| Legal Services Rendered Re Dissolution of Marriage, Our File No. 5188-3684 | \$1,750.00 |
| Costs Advanced - County Clerk - filing fees | <u>36.50</u> |
| T o t a l | \$1,786.50 |

Of the above amount \$1,200.00 represents the amount which is tax deductible.

This account has been paid in full as of October 17, 1975.

Appellant also submitted a letter from his attorney dated January 19, 1977, which stated, in pertinent part:

With reference to the March 18, 1976 bill for legal services rendered in 1975, please be advised that the \$1,200.00 indicated as tax deductible pertains to legal services and advice with respect to a production of income. In particular, this time was spent in determining spousal support and matters pertaining to your business. The balance of the fees and costs represent what can be classified as fees in connection with a divorce or property settlement.

As further amplification of the nature of the legal services provided, appellant's counsel stated:

The consultation for which deduction is claimed involves time spent in business matters,

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including discussion of a buy-sell agreement, among other problems, evaluation of the business in connection therewith, and revision of same, and time spent in connection with spousal support having a tax consequence to both parties.

In the case of an individual, section 17252 of the Revenue and Taxation Code provides for the deduction of all ordinary and necessary expenses paid or incurred during the taxable year:

(a) For the production or collection of income;

(b) For the management, conservation, or maintenance of property held for the production of income; or

(c) In connection with the determination, collection, or refund of any tax.

On the other hand, section 17282 of the Revenue and Taxation Code prohibits any deduction "for personal, living, or family expenses." Sections 17252 and 17282 are the same as sections 212 and 262 of the Internal Revenue Code of 1954. Under such circumstances, the interpretation and effect given the federal provisions are highly persuasive with respect to proper application of the state law. (Holmes v. McColgan, 17 Cal. 2d 426, 430 [110 P.2d 4281 cert. den., 314 U.S. 636 [86 L. Ed. 5101 (1941)]; Rihn v. Franchise Tax Board, 131 Cal. App. 2d 356, 360 [280 P.2d 893] (1955).)

It is not clear which subsection of section 17252 appellant relies on to justify the deductibility of the legal fees in question. We will, therefore, consider each subsection separately.

Subsection (a) provides for the deduction of all ordinary and necessary expenses paid or incurred during the taxable year for the "production or collection of income." In Ruth K. Wild, 42 T.C. 706 (1964), the United States Tax Court held that legal fees which represent the cost to a wife of producing monthly alimony payments, which are includible in gross income are deductible under section 212, subsection (1) of the Internal Revenue Code of 1954. Appellant maintains that the legal expenses in question were rendered in respect to a production of income, specifically, in determining spousal

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support, The expenses incurred by the former Mrs. Lee in producing alimony which was includible in her gross income may have been deductible in accordance with Ruth K. Wild, supra. However, we are unable to discern how any of these legal expenses were for the "production or collection of income" on appellant's behalf, and appellant has offered nothing in this regard. Accordingly, we must conclude that the expenses are not deductible under subsection (a) of section 172.52..

Next, we consider subsection (b) which provides for the deduction of all ordinary and necessary expenses paid or incurred during the taxable year for the "management, conservation, or maintenance of property held for the production of income." The claimed deductibility of legal fees incurred incident to a divorce under this subsection is foreclosed by the decisions of the United States Supreme Court in United States v. Gilmore, 372 U.S. 39 [9 L. Ed. 2d 570] (1963) and United States v. Patrick, 372 U.S. 53 [9 L. Ed. 2d 580] (1963). The pivotal question in both those cases was whether the taxpayer's legal costs were a "business" expense rather than a "personal" expense. The characterization as "business" or "personal" of the litigation costs of resisting a claim depends on whether or not the claim arises in connection with the taxpayer's profit-seeking activities. It does not depend on the consequences that might result to a taxpayer's income-producing property from a failure to defeat the claim. (United States v. Gilmore, supra.) The Court determined that the wife's claims stemmed entirely from the marital relationship and not from any income-producing activity. Since the expenses were "personal" and not "business" expenses, the Court concluded that none of the husband's legal expenses were deductible under the federal counterpart of section 17252, subsection (b). (United States v. Gilmore, supra.)

In denying a similar claim, the Patrick Court found that the claims asserted by the wife in the divorce action arose from the marital relationship and were, therefore, the product of the parties' personal or family lives, not the husband's profit-seeking activity. (United States v. Patrick, supra.) The Court could find no distinction in the fact that the legal fees were paid for arranging a stock transfer, leasing real property, and creating a trust rather than for conducting litigation. These matters were incidental to litigation brought by the wife, whose claims arising from the taxpayer's personal and family life were the origin of the property arrangements. (United States v. Patrick, supra.)

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Finally, we consider subsection (c) which allows the deduction of all ordinary and necessary expenses paid or incurred during the taxable year in connection with "the determination, collection, or refund of any tax." A number of decisions have allowed a deduction for legal expenses incurred in cases involving matrimonial separations or divorces where advice was sought concerning the tax impact of the various agreements connected with the separation. (Davis v. United States, 287 F.2d 168 (Ct. Cl. 1961) revd. in part and affd. in part on other grounds, 370 U.S. 65 [8 L. Ed. 2d 3351 (1962)]; Carpenter v. United States, 338 F.2d 366 (Ct. Cl. 1964); Matthews v. United States, 425 F.2d 738 (Ct. Cl. 1970); George v. United States, 434 F.2d 1336 (Ct. Cl. -1970); Munn v. United States, 455 F.2d 1028 (Ct. Cl. 1972); see also Kauffmann v. United States, 227 F. Supp. 807 (W.D. Mo. 1963); Palmquist v. United States, 284 F. Supp. 577 (N.D. Cal. 1967); see generally Weaver, The Merians Decision: What Are Its Implications For Tax Planning Deductions?, 39 J. Tax. 348 (Dec. 1973).)

While completely ignoring this line of authority, respondent seeks to deny the deduction in its entirety, asserting that appellant has failed to meet his burden of proof in establishing what portion of the legal expense is allocable to tax advice. It is elementary, of course, that the taxpayer has the burden of proving that he is entitled to a deduction. However, not even the authority relied on by respondent, Sidney Merians, 60 T.C. 187 (1973), requires that the deduction be denied in total. ^{1/}

Merians involved an individual who retained a law firm to develop an estate plan for him and his wife. Ultimately, the taxpayer was billed \$2,144 for the 42.8 hours expended in developing and implementing the estate plan. The taxpayer deducted the entire amount pursuant

^{1/} In view of the dissenting opinions in Merians, it has been suggested that the future of deductions such as the one at issue in this appeal is in doubt in the United States Tax Court. (See Weaver, The Merians Decision: What Are Its Implications For Tax Planning Deductions?, 39 J. Tax. 348 (Dec. 1973).) However, Merians is simply an allocation case; it is not authority for disallowing the claimed deduction in its entirety.

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to the federal counterpart of section 17252, subsection (c). Before the United States Tax Court the government conceded that some of the legal fee represented services which were deductible under the subsection in question. However, the government argued, as respondent does here, that since the taxpayers failed to meet their burden of proving what portion of the fees represented tax advice, they should be denied any deduction. The record did not contain an itemization of the services performed or the time spent on each activity. The court recognized that in establishing an estate plan, choices made for personal nontax reasons may have tax implications, but the consideration of such implications does not convert into tax advice the advice given concerning nontax problems. Nevertheless, the court concluded that an allocation was both possible and appropriate. In view of the state of the record, however, the allocation was weighted heavily against the taxpayers. (Sidney Merians, supra, 60 T.C. at 190.)

In the present appeal we are also faced with a skimpy record. we do know, however, that a buy-sell agreement was prepared and revised, requiring among other things a valuation of appellant's interest in his business, and that a plan for spousal support was negotiated seeking, apparently, to maximize the tax benefits to appellant. Additionally, of course, a dissolution of appellant's marriage was obtained. The total legal expenses paid for these services was \$1,786.50. Of this amount, \$1,200.00 was claimed as a tax deduction. Unfortunately, we do not have an itemization of the specific services performed or the time spent on each activity. This does not render it impossible for us to make an allocation since it is apparent that some portion of the amount incurred for legal services related to tax matters. (See Munn v. United States, supra, 455 F.2d at 1035.) In view of the record, however, the allocation must be weighted heavily against appellant. We find that \$300.00 of the total amount expended for legal services was for tax advice.. (Cohan v. Commissioner, 39 F.2d 540, 543-44 (2d Cir. 1930); Sidney Merians, supra, 60 T.C. at 190.) Such amount is deductible pursuant to section 17252, subsection (c) of the Revenue and Taxation Code. Accordingly, respondent's action must be modified to reflect this determination.

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O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Curtis H. Lee against a proposed assessment of additional personal income tax in the amount of \$131.85 for the year 1975, be and the same is hereby modified in accordance with the views expressed in this opinion. In all other respects, the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 26th day of July, 1978, by the State Board of Equalization.

George R. Peck Chairman
Paul H. Lee Member
William K. Brundage Member
Mrs. Sankey Member
_____. Member